

Internal Revenue Service

Department of the Treasury

Washington DC 20224

Person to Contact

Telephone Number

Refer Reply to:

Date: **FEB 25 1986**

DO:   
EIN:

Dear Applicant:

This is in reply to your application for recognition of exemption under section 501(c)(3) of the Internal Revenue Code of 1954.

You are a self management, self help cooperative housing organization which leases only to low and moderate income households. Your Articles of Incorporation indicate that your purposes are to provide leased cooperative housing, community facilities and other goods and services for households earning not more than eighty percent of the [REDACTED] area median income as determined by the United States Department of Housing and Urban Development.

You have rented an apartment building for a 20 year term. At the end of this period you have the right of first refusal to purchase the building. The building was rennovated by the owner with funds provided by a City Block Grant of \$[REDACTED] and a [REDACTED] year loan of \$[REDACTED] from the United States Department of Housing and Urban Development. The building has apparently not been occupied since [REDACTED].

The owner of the building leases it to you and you in turn lease the units to the individual tenants. The monthly rental payments made by the tenants are set by governmental guidelines. However, in addition to the lease payment you make to the owner of the building, you pay all utility bills, assessments, property taxes and make payments on the construction loan taken out to rennovate the building.

As a cooperative organization, your activities are directed by your members. Membership is open to all tenants and apparently anyone is eligible to become a tenant. Application for membership in the organization serves as a waiting list for vacancies in the building.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term charitable includes relief of the poor and distressed or of the underprivileged and the promotion of social welfare by organizations designed to accomplish any of the above purposes or to (i) lessen neighborhood tensions, (ii) eliminate prejudice and discrimination, (iii) defend human and civil rights secured by law, or (iv) combat community deterioration and juvenile delinquency.

Section 1.501(c)(3)-1(b)(1) of the regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization limit its purposes to one or more exempt purposes and do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(b)(4) of the regulations provides that an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. This requirement, states among other things, that upon dissolution of the organization its assets be distributed exclusively for exempt purposes.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized and operated exclusively for charitable purposes unless it serves a public rather than a private interest.

Rev. Rul. 65-201, 1965-2 C.B. 170 holds that a cooperative housing organization operated for the personal benefit of its tenant-owner members does not qualify for exemption from Federal income tax.

Rev. Rul. 66-259, 1966-2 C.B. 214 holds that a trust which provides for the reversion of principal on termination to the creator does not qualify for recognition of exemption under section 501(c)(3) of the Code.

Rev. Rul. 69-175, 1969-1 C.B. 149 holds that a nonprofit organization formed by parents of pupils attending a private school, that provides school bus transportation for its member's children serves a private rather than a public purpose and does not qualify for exemption under section 501(c)(3) of the Code. When a group of individuals associate to provide a cooperative service for themselves they are serving a private interest.

Rev. Rul. 70-585, 1970-2 C.B. 115 holds that nonprofit organizations providing housing to low, and in certain circumstances, moderate income families may qualify for exemption under section 501(c)(3) as a charitable organization.

In Texas Trade School, 30 T.C. 642 Dec. 23, 1940, aff'd per curiam, 272 F.2d 168 (1959) the Court denied recognition of exemption under section 501(c)(3) to an organization which made valuable improvements upon land which was to revert to the private owners after a period of years even though the building was used for exempt purposes during the interim period.

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An organization providing housing to low and moderate income families may qualify for exemption under section 501(c)(3) of the Code. See Rev. Rul. 70-585. However, in order to so qualify an organization must satisfy the requirements of the organizational and operational tests of section 501(c)(3).

In Rev. Rul. 65-201 and 69-175 the Service held that cooperative endeavors generally operate to serve the private interests of their members. The information you have submitted establishes that you operate as a cooperative endeavor for your tenants and potential tenants. Although the apartment building is not owned in fee simple by you or the tenants, you do have the right of first refusal to purchase the building at the end of the 20 year lease. Furthermore, because your activities are directed by the tenants and potential tenants and your rents are strictly limited, your members hold basically all the rights of ownership except for resale. Accordingly, you serve as a vehicle for your members to further their own interests as tenants. In short, you are a self-serving endeavor operated for the mutual and personal benefit of your members. Accordingly, we have concluded that you do not qualify for recognition of exemption under section 501(c)(3) of the Code.

In addition, the owner of the building has been unreasonably benefited by your operations. It appears that by reason of your involvement the owner of the building was able to take a previously unoccupied building, borrow funds through a government subsidized loan program and have the building rennovated. More importantly, at the end of the term of the lease the rennovated building may revert to the owner. In the Texas Trade School case, a similar arrangement was held to preclude exemption under section 501(c)(3) of the Code.

Accordingly, we have concluded that you serve the private interests of your members by operating on a cooperative basis and you serve the private interests of the owner of the building because the substantially improved building may revert to here upon termination of the lease.

Furthermore, you do not satisfy the requirements of the organizational test of section 501(c)(3) of the Code. As previously explained, the purpose of operating a cooperative housing endeavor is not an exempt purpose. In addition, because you do not have a clause in your governing instrument providing for the distribution of your remaining assests upon termination for an exempt purpose you do not satisfy the requirements of the organizational test.

Therefore, we have concluded that you do not qualify for recognition of exemption under section 501(c)(3) of the Code.

You are required to file federal income tax returns on Form 1120. Contributions to you are not deductible under section 170 of the Code.

[REDACTED]

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your principal officers, must be submitted within 21 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practice Procedures.

If you do not protest this proposed ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code provides, in part, that, "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

If we do not hear from you within 21 days, this ruling will become final and copies will be forwarded to the District Director. Thereafter, any questions about your federal tax status should be addressed to that office. Also, the appropriate State officials will be notified of this action in accordance with section 6104(c) of the Code.

Sincerely yours,

[REDACTED]

Chief, Exempt Organizations  
Rulings Branch

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